

## Price hikes taken to support margin recovery...

**About the stock:** Zydus Wellness (ZWL) is one of the FMCG companies present in the healthcare, nutrition & related products space. The company has six brands i.e. Sugarfree, Complan, Glucon-D, Nycil, Everyuth & Nutralite.

- It commands a dominant market share in sugar substitute (95%), prickly heat powder (35%) and glucose powder (60%) categories
- The company has more than 850 distributors with direct reach of 0.6 million retail outlets. Its high gross margins at ~55% give it leeway to spend ~12-13% of sales on advertisement to support new products

**Q2FY23 Results:** Zydus reported sales growth of 11.9% led by 5% volume growth.

- Sales grew 11.9% led by strong double digit growth in Glucon-D, Nutralite
- EBITDA was dismal at ₹ 16.3 crore, down 46.8% YoY, with margins at 3.8%
- Consequent adjusted PAT was at ₹ 8.2 crore, down 60.9%

**What should investors do?** Zydus Wellness' share price has given 82% return in the last five years (from ₹ 892 in November 2017 to ₹ 1620 in November 2022).

- High inflation in milk is adversely impacting margins. The company has taken addition price hike of 2%, which would help in margins recovery
- We maintain our **BUY** rating on the stock

**Target Price and Valuation:** We value the stock at ₹ 2100 on ascribing 30x FY24 earnings multiple.

### Key triggers for future price performance:

- RM inflation is likely to cool down by H2FY23, which would give leeway to spend behind brands aggressively. Likely to perk up volume growth
- Brand extensions and new variant launches in Glucon-D, Complan, Sugarfree, Nutralite to aid revenue growth
- Expansion in direct distribution, chemist channel sales and doctor's advisory to play pivotal role in growing the business

**Alternate Stock Idea:** We like Dabur in our FMCG coverage.

- Significant shift in consumption towards healthier, natural & Ayurveda based products & aggressive foray in many big categories (edible oil, carbonated drink, household insecticides, fruit drinks) would be driving growth for Dabur
- Value the business at 55x FY24 earnings. BUY with TP of ₹ 700



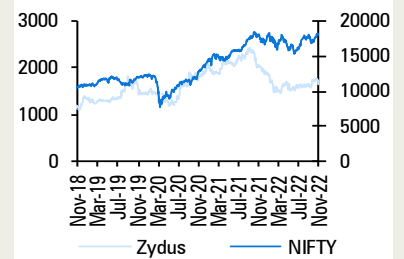
### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	10,308.1
Total Debt (FY22)	381.5
Cash and Investments (FY22)	196.8
EV	10,492.7
52 week H/L (₹)	2472/ 1431
Equity capital	57.7
Face value (₹)	10.0
FII Holding (%)	4.4
DII Holding (%)	19.3

### Shareholding pattern

(in %)	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	64.8	64.8	65.1	65.4
FII	3.4	2.6	2.4	3.2
DII	24.8	25.1	25.1	23.8
Others	7.0	7.5	7.4	7.6

### Price Chart



### Recent event & key risks

- ZWL is expanding its direct distribution network to 1 million outlets in next three years
- **Key Risk:** (i) Persistent inflation in milk could continue to pressurise margins in longer run (ii) High competitive intensity in Complan

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### Key Financial Summary

₹ Crore	FY20	FY21	FY22	5 Year CAGR (FY17 to FY22)	FY23E	FY24E	CAGR FY22-24E
Net Sales	1,763.7	1,866.7	2,009.1	36.1%	2,289.9	2,529.6	12.2%
EBITDA	318.0	344.4	344.8	28.3%	401.8	488.0	19.0%
EBITDA Margin %	18.0	18.4	17.2		17.5	19.3	
Adjusted Net Profit	182.8	250.9	308.9	23.2%	359.6	447.1	20.3%
Adjusted EPS (₹)	31.7	39.4	48.5	28.3%	56.5	70.3	20.3%
Adjusted P/E (x)	51.1	41.1	33.4		28.7	23.1	
RoCE (%)	5.8	6.2	6.1		7.0	8.3	
RoE (%)	5.3	5.5	6.4		7.2	8.6	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter

### Q2FY23 Results: Milk prices remain elevated; price hike, cooling down of other commodities to support margins

- Revenue witnessed growth of 11.9% to ₹ 429.5 crore led by 6% pricing growth and 5% volume growth. The company has gained market share in all categories except Complan
- Sugar free brand continued its leadership in its category with a market share of over 95%. The brand saw flattish growth during the quarter due to high base. On three-year CAGR basis the growth in the brand is high single digit
- ZWL has doubled direct distribution of Sugar-free Green in the last three months. New initiatives like Sugar free green & Sugar free lite are witnessing strong growth and now contributing 14% of total sugar free sales
- Glucon-D continued to lead the glucose powder category with a value market share of 60.0%, which is higher by 157 bps in last one year. The brand registered strong double digit sales growth in the second summer. The company continued investment behind brand even after peak summer season. The brand witnessed strong growth after two years of subdued sales adversely impacted by Covid-19
- The HFD category is de-growing from last three quarters (3% value de-growth between January-September 2022), which was reflected in Complan sales as well.
- Given HFD category has gone through restructuring by concentrating largely on smaller pack or sachets, which used to be 12-15% of category sales earlier, is now contributing 27% of sales. Rural sachets used to be a rural region, South & East India phenomenon. However, sachets are growing faster in other geographies like North & West as well now
- The effective price in the HFD category has declined in the last three years on account of consumption shift towards small SKUs. The company was behind the category in driving sachets volumes. ZWL has launched sachets & pouches in key market now. The benefits from that have been reflected in curbing market share fall. It has been able to maintain market share of 4.6% in the HFD category
- Nycil has maintained its number one position with a market share of 35% in the Prickly heat powder category, which was higher by 47 bps compared to last year. The brand saw strong doubled digit growth due to extended monsoon
- Nutralite brand has registered healthy double-digit growth. Nutralite DoodhShakti dairy portfolio, which includes butter, spreads and ghee delivered strong performance backed by increased distribution drive, digital activation in festive season & brand endorsements. Nutralite would be among four to five brands for the company and the opportunity size in targeted categories like butter & other milk product is large
- Everyuth brand saw strong double digit growth across products. Everyuth brand commands market share of 6.5% in the overall facial cleansing segment maintaining its No. 5 position. Everyuth Scrub saw market share gain of 269 bps with 41.8% in the facial scrub category. Everyuth Peel off has maintained its No. 1 position with a market share of 75.7% in the peel off category
- Though edible oil prices have come down in last six months, milk prices continue to remain elevated. Gross margin contracted by 491 bps during the quarter. Overhead spends were also higher by 47 bps compared to last year. The company was able to save 87 bps and 34 bps towards employee and advertisement spends, respectively, during the quarter

- The company has taken 2% price increase at the portfolio level in Q2 to cover inflation. Overall increase in commodity basket has been 3.5% sequentially. With price hike & expected softening of raw material prices, gross margins would improve sequentially & full impact of these intervention would be realised Q4FY23 onwards
- Operating profit declined 46.8% to 16.3 crore with operating margin contraction of 417 bps to 3.8%. Net profit dipped by 60.9% to ₹ 8.2 crore on account of de-growth in operating profit and other income
- Rural region sales contribute 25% of ZWL’s sales, which continues to remain impacted by high commodity inflation and, in turn, witnessed down-trading. However, urban demand conditions have improved
- The company has increased its direct & indirect distribution reach to 0.6 & 2.5 million retail outlets, respectively. The total reach of 2.5 million outlets has been equal between urban & rural. ZWL is looking to increase its direct & indirect distribution reach to 1 million & 3+ million outlets, respectively, in the next three years
- The sales contribution from MT & Ecommerce have increased from 14% in FY21 to 18% in FY22. The company is aiming it to increase it to 25% in the next few years. The ecommerce channel sales contributed 8.6% of sales in Q2FY23 compared to 7.7% last year

**Exhibit 1: Peer Comparison**

Sector / Company	CMP	TP	M Cap	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)			
	(₹)	(₹) Rating		(₹ Cr)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Hindustan Unilever (HINLEV)	2501	2800	Hold	623766	11.3	14.8	8.5	24.8	24.1	24.5	66.6	58.9	53.7	18.1	20.3	22.0	20.2	22.8	25.1
Nestle (NESIND)	20260	22400	Hold	190912	10.2	14.3	10.5	24.5	22.3	24.1	91.1	79.2	67.3	111.3	103.6	110.3	58.7	57.1	63.0
Zydus Wellness (ZYDWEL)	1620	2100	Buy	10308	7.6	14.0	10.5	17.2	17.5	19.3	33.4	28.7	23.1	6.4	7.2	8.6	6.1	7.0	8.3

Source: Company, ICICI Direct Research

Zydus Wellness has seen two years of subdued volume growth due to adverse impact of Covid-19 for summer products. Moreover, high inflation in milk, edible oil & crude based packaging costs led to sharp gross margin contraction in last one year. We believe softening of some commodities along with pricing interventions by the company to the tune of 8-10% (in last one year) would help in recovering margins, going forward. With the effort towards increasing direct distribution network, new product launches within the categories or adjacencies and sustained marketing spends is likely to drive volumes. We believe expected softening of commodity inflation would also help in recovering rural demand. We maintain our BUY recommendation on the stock and target price of ₹ 2100/share.

**Exhibit 2: Variance Analysis**

	Q2FY23	Q3FY22E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Net Sales	429.5	429.1	383.7	11.9	696.8	-38.4	Net sales witnessed growth of 11.9% led by 5% volume growth and 6% pricing growth
Raw Material Expenses	243.5	227.1	198.7	22.6	250.1	-2.7	higher prices of milk, inferior product mix and rupee depreciation
Employee Expenses	43.6	45.3	42.3	3.1	45.1	-3.2	
SG&A Expenses	51.7	53.6	47.5	8.8	96.2	-46.3	The company maintained its ad spend during the quarter
Other operating Expenses	74.4	70.8	64.6	15.1	88.8	-16.2	Overhead spends increased due to higher fuel prices like coal & husk & increase in wage rate in North East
EBITDA	16.3	32.3	30.5	-46.8	148.1	-89.0	
EBITDA Margin (%)	3.8	7.5	8.0	-417 bps	21.3	-1747 bps	Operating margins contracted on account of pressure of commodity inflation & gross margins
Depreciation	6.4	6.4	6.1	5.2	6.0	6.5	
Interest	2.9	3.4	6.7	-56.1	4.1	-29.0	Interest cost reduced substantially with complete repayment of debt
Other Income	1.4	2.5	3.4	-59.8	2.0	-30.8	
PBT	8.2	25.0	21.1	-60.9	139.9	-94.1	
Exceptional Items	0.0	0.0	0.0	NA	-2.9	NA	
Tax Outgo	0.0	0.0	0.0	NA	0.0		
PAT	8.2	25.0	21.1	-60.9	137.0	-94.0	Net profit was down by 60.9% impacted by decline in operating profit
Adjusted PAT	8.2	25.0	21.1	-60.9	137.0	-94.0	

Source: Company, ICICI Direct Research

**Exhibit 3: Change in estimates**

₹ Crore)	FY23E			FY24E			Comments
	Old	New	% change	Old	New	% change	
Sales	2,258.3	2,289.9	1.4	2494.3	2529.6	1.4	We slightly change our sales estimate
EBITDA	408.3	401.8	-1.6	492.4	488.0	-0.9	We factor in higher milk prices in FY23
EBITDA Margin (%)	18.1	17.5	-53 bps	19.7	19.3	-45 bps	
Adjusted PAT	366.0	359.6	-1.8	451.5	447.1	-1.0	
EPS (₹)	57.5	56.5	-1.8	71.0	70.3	-1.0	

Source: ICICI Direct Research

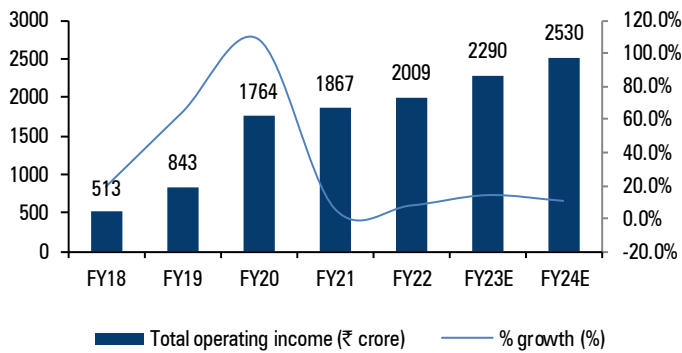
**Exhibit 4: Assumptions**

	Current						Earlier		Comments
	FY20E	FY21E	FY22E	FY23E	FY24E	FY23E	FY24E		
Sugarfree & others (₹ crore)	344.7	386.0	433.6	477.6	521.3	477.6	521.3		
Everyuth (₹ crore)	178.3	169.9	197.6	225.7	250.9	225.7	250.9		
Glucon D (₹ crore)	472.0	505.3	535.9	612.2	686.9	584.9	656.2	We raise our estimate for Glucon-D sales given strong growth in last few quarters	
Complan (₹ crore)	378.0	404.5	445.3	486.0	535.3	486.0	535.3		
RM / Sales (%)	42.7	39.8	44.0	42.7	43.7	43.4	42.4		

Source: ICICI Direct Research

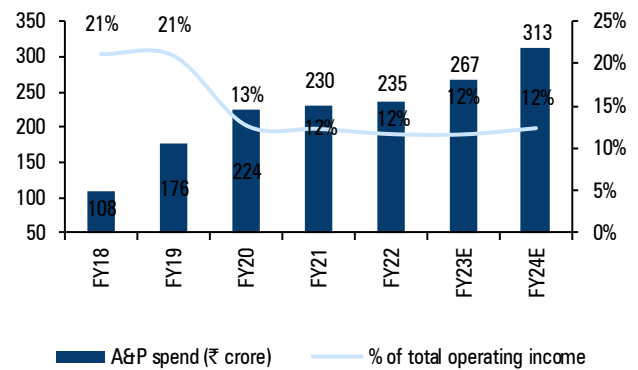
## Key Metrics

Exhibit 5: Revenue & revenue growth trend



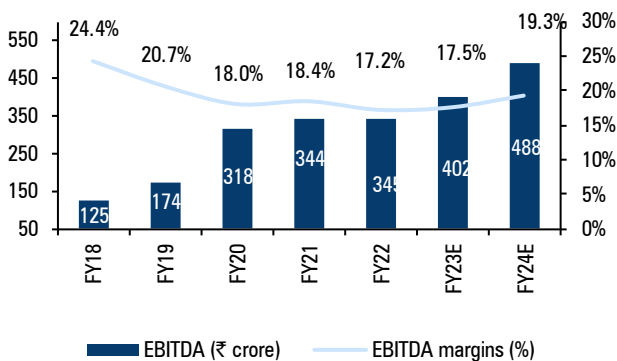
Source: ICICI Direct Research, Company

Exhibit 6: Marketing spend trend



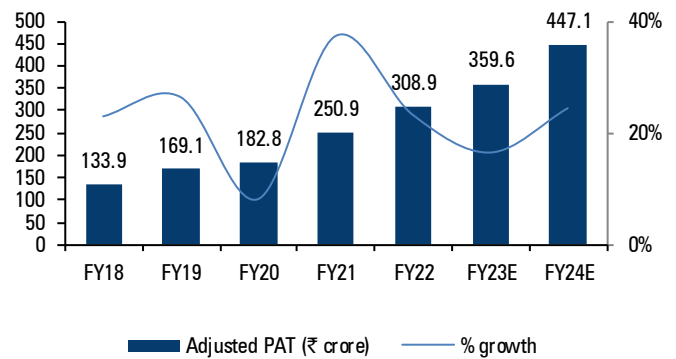
Source: ICICI Direct Research, Company

Exhibit 7: Operating margins trend (%)



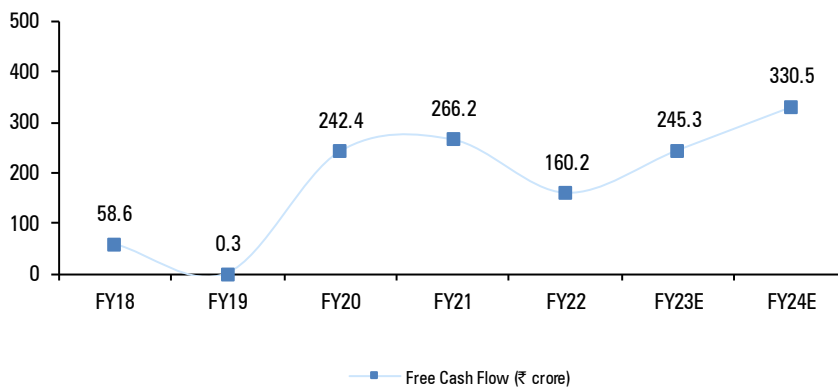
Source: Company, ICICI Direct Research

Exhibit 8: Adjusted PAT growth trend



Source: Company, ICICI Direct Research

Exhibit 9: Free cash flow (₹ crore)



Source: ICICI Direct Research

Exhibit 10: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY21	1866.7	5.8	39.4	24.3	86.8	30.8	5.5	6.2
FY22	2009.1	7.6	48.5	23.1	33.4	30.5	6.4	6.1
FY23E	2289.9	14.0	56.5	16.4	28.7	26.1	7.2	7.0
FY24E	2529.6	10.5	70.3	24.3	23.1	21.4	8.6	8.3

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Total operating Income</b>	<b>1,866.7</b>	<b>2,009.1</b>	<b>2,289.9</b>	<b>2,529.6</b>
Growth (%)	5.8	7.6	14.0	10.5
Raw Material Expenses	844.9	980.4	1,149.8	1,231.3
Employee Expenses	163.8	163.6	176.2	207.8
Marketing Expenses	229.6	234.8	266.7	313.1
Administrative Expenses	0.0	0.0	107.2	107.9
Other expenses	303.6	285.7	188.1	181.5
Total Operating Expenditure	1,541.8	1,664.4	1,888.1	2,041.6
<b>EBITDA</b>	<b>324.8</b>	<b>344.8</b>	<b>401.8</b>	<b>488.0</b>
Growth (%)	2.2	6.1	16.6	21.4
Depreciation	25.2	23.6	32.1	34.9
Interest	83.8	25.5	22.5	19.1
Other Income	8.9	10.4	12.4	13.0
PBT	224.8	306.0	359.6	447.1
Total Tax	-6.5	-2.9	0.0	0.0
Exceptional Item	132.1	0.0	0.0	0.0
<b>PAT</b>	<b>99.2</b>	<b>308.9</b>	<b>359.6</b>	<b>447.1</b>
<b>Adjusted PAT</b>	<b>250.9</b>	<b>308.9</b>	<b>359.6</b>	<b>447.1</b>
Growth (%)	81.0	23.1	16.4	24.3
Adjusted EPS (₹)	39.4	48.5	56.5	70.3

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit After Tax	112.4	301.9	359.6	447.1
Add: Depreciation	25.2	23.6	32.1	34.9
(Inc)/dec in Current Assets	191.8	-14.0	-160.2	-154.1
Inc/(dec) in CL and Provisions	-42.8	-74.7	55.2	52.7
<b>CF from operating activities</b>	<b>286.5</b>	<b>236.9</b>	<b>286.7</b>	<b>380.5</b>
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	-1.9	0.0	-10.0	-10.0
(Inc)/dec in Fixed Assets	-17.5	-74.7	-41.4	-50.0
Others	8.9	15.8	-5.0	-5.0
<b>CF from investing activities</b>	<b>-10.4</b>	<b>-58.9</b>	<b>-56.4</b>	<b>-65.0</b>
Issue/(Buy back) of Equity	986.6	0.0	0.0	0.0
Inc/(dec) in loan funds	-1,187.5	-168.3	-100.0	-42.5
Dividend paid & dividend tax	-0.2	-31.9	-190.9	-254.5
Interest Paid	-101.2	-32.5	-22.5	-19.1
Others	0.0	0.0	0.0	0.0
<b>CF from financing activities</b>	<b>-302.3</b>	<b>-232.6</b>	<b>-313.4</b>	<b>-316.1</b>
Net Cash flow	-26.2	-54.7	-83.2	-0.7
Opening Cash	192.8	252.7	169.8	86.6
Cash with Bank	0.0	0.0	0.0	0.0
<b>Closing Cash</b>	<b>166.7</b>	<b>198.0</b>	<b>86.6</b>	<b>86.0</b>

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Liabilities</b>				
Equity Capital	63.6	63.6	63.6	63.6
Reserve and Surplus	4,504.2	4,780.4	4,949.1	5,141.6
Total Shareholders funds	4,567.8	4,844.0	5,012.7	5,205.2
LT Borrowings & Provisions	312.5	62.5	12.5	0.0
Deferred Tax Liability	237.3	319.0	269.0	239.0
Others Non-current Liabilities	15.2	18.8	18.8	18.8
<b>Total Liabilities</b>	<b>5,132.8</b>	<b>5,244.4</b>	<b>5,313.0</b>	<b>5,463.1</b>
<b>Assets</b>				
Gross Block	412.7	452.7	492.7	532.7
Less: Acc Depreciation	193.2	216.8	249.0	283.9
Net Block	199.6	244.5	243.7	248.9
Capital WIP	3.7	11.9	21.9	31.9
Goodwill	3,920.0	3,920.0	3,920.0	3,920.0
Non-current Investments	1.4	5.5	5.5	5.5
LT loans & advances	11.7	0.0	10.0	20.0
Deferred Tax Assets	126.5	129.8	129.8	129.8
Other Non-Current Assets	556.6	566.7	571.7	576.7
<b>Current Assets</b>				
Inventory	364.7	361.6	414.1	457.4
Debtors	94.3	142.3	156.8	173.3
Loans and Advances	0.0	0.0	0.0	0.0
Other Current Assets	135.2	112.9	128.7	142.2
Cash	252.7	169.8	86.6	86.0
Investments	0.0	27.0	127.0	227.0
<b>Current Liabilities</b>				
Creditors	438.6	364.3	407.8	450.5
Provisions	0.0	21.9	24.9	27.5
Short term debt & other CL	95.1	61.7	70.3	77.7
<b>Application of Funds</b>	<b>5,132.8</b>	<b>5,244.4</b>	<b>5,313.0</b>	<b>5,463.1</b>

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Per share data (₹)</b>				
EPS	39.4	48.5	56.5	70.3
Cash EPS	22.6	52.3	61.6	75.7
BV	717.9	761.3	787.8	818.0
DPS	10.0	25.0	30.0	40.0
Cash Per Share	39.7	26.7	13.6	13.5
<b>Operating Ratios (%)</b>				
EBITDA Margin	18.4	17.2	17.5	19.3
PBT / Total Operating income	13.1	15.2	15.7	17.7
PAT Margin	6.4	15.4	15.7	17.7
Inventory days	71.3	65.7	66.0	66.0
Debtor days	18.4	25.9	25.0	25.0
Creditor days	85.8	66.2	65.0	65.0
<b>Return Ratios (%)</b>				
RoE	5.5	6.4	7.2	8.6
RoCE	6.2	6.1	7.0	8.3
<b>Valuation Ratios (x)</b>				
P/E	86.8	33.4	28.7	23.1
EV / EBITDA	30.8	30.5	26.1	21.4
EV / Net Sales	5.7	5.2	4.6	4.1
Market Cap / Sales	5.5	5.1	4.5	4.1
Price to Book Value	2.3	2.1	2.1	2.0
<b>Solvency Ratios</b>				
Debt/EBITDA	1.6	1.1	0.7	0.5
Debt / Equity	0.1	0.1	0.1	0.0
Current Ratio	1.1	1.4	1.4	1.4
Quick Ratio	0.4	0.6	0.6	0.6

Source: Company, ICICI Direct Research

**Exhibit 15: ICICI Direct coverage universe (FMCG)**

	CMP	TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)			
	(₹)	(₹) Rating		(₹ Cr)	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Colgate (COLPAL)	1,586	1,610	Hold	43,606	39.6	38.6	42.3	40.0	41.1	37.5	8.6	8.2	7.5	77.8	82.6	92.7	62.2	62.9	70.8
Dabur India (DABIND)	554	700	Buy	97,076	9.9	10.9	12.7	56.2	51.0	43.7	8.9	8.2	7.2	24.9	24.6	26.5	20.8	21.4	22.6
Hindustan Unilever (HINLEV)	2,501	2,800	Hold	6,23,766	37.5	42.4	46.5	66.6	58.9	53.7	12.4	10.8	9.9	20.2	22.8	25.1	18.1	20.3	22.0
ITC Limited (ITC)	356	405	Buy	4,29,858	12.4	14.2	16.7	28.7	25.0	21.3	7.3	6.1	5.7	31.4	35.3	38.8	24.5	27.1	29.7
Jyothy Lab (JYOLAB)	191	145	Hold	6,077	4.3	5.6	6.4	44.8	34.1	30.0	2.8	2.5	2.3	18.7	24.2	27.7	16.6	21.2	23.8
Marico (MARLIM)	500	560	Hold	69,587	9.7	10.2	11.2	51.4	49.0	44.5	7.3	7.1	6.5	41.2	43.6	46.7	37.5	38.3	41.0
Nestle (NESIND)	20,260	22,400	Hold	1,90,912	222.4	255.8	301.1	91.1	79.2	67.3	13.0	11.4	10.3	58.7	57.1	63.0	111.3	103.6	110.3
Patanjali Foods (RUCSOY)	1,289	1,750	Buy	50,721	27.3	30.9	43.5	47.3	41.7	29.7	2.1	1.7	1.5	13.2	15.6	17.3	13.1	11.3	14.2
Tata Consumer Products (TAT)	772	950	Buy	70,169	11.0	13.9	17.1	70.1	55.5	45.1	5.6	5.1	4.6	8.4	9.2	10.8	7.0	8.2	9.7
Varun Beverage (VARBEV)	1,119	1,235	Hold	71,889	17.2	23.2	26.8	64.9	48.2	41.8	8.1	5.6	5.0	17.1	30.3	33.5	18.3	29.0	29.4
VST Industries (VSTIND)	3,525	3,725	Hold	5,615	207.4	228.7	248.3	17.0	15.4	14.2	4.8	4.4	4.0	39.2	43.7	49.9	30.0	33.3	37.5
Zydus Wellness (ZYDWEL)	1,620	2,100	Buy	10,308	48.5	56.5	70.3	33.4	28.7	23.1	5.1	4.5	4.1	6.1	7.0	8.3	6.4	7.2	8.6

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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